INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	2
Specification of errors to be urged	5
Argument	5
Conclusion	8
Appendix	9

CITATIONS

Cases:	
American Bd. Comm'rs v. *Bugbee*, 98 N. J. L. 84	8
Barber's Estate, 304 Pa. 235	8
Bullard v. *Commissioner*, 90 F. (2d) 144; No. 349, present Term	5
Conwell's Estate, 5 Pa. Co. Ct. 368	8
Harvey, In re, 2 N. J. Misc. 247, affirmed, *sub nom. Moore* v. *Bugbee*, 3 N. J. Misc. 435, affirmed, 102 N. J. L. 720, writ of error dismissed, 278 U. S. 565	8
Hubbe, In re, 41 Ariz. 466	8
Meyers's Estate, 16 Pa. Dist. Rep. 284	8
Miller, Matter of, 236 N. Y. 290	8
Ogden, Estate of, 209 Wis. 162	8
People v. *Estate of Moir*, 207 Ill. 180	8
Perry, In re, 111 N. J. Eq. 176	8
Reish, Adm'r v. *Commonwealth*, 106 Pa. 521	8
Schuh, In re Estate of, 66 Mont. 50	8
Wallace's Estate, In re, 282 Pac. 760	8
Welch v. *Hassett*, 90 F. (2d) 833; No. 375, present Term	5, 7
Statutes:	
Joint Resolution of March 3, 1931, c. 454, 46 Stat. 1516 (U. S. C., Title 26, Sec. 411 (c))	9
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 302 (U. S. C., Title 26, Sec. 411)	9, 10
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 303 (U. S. C., Title 26, Sec. 411)	10
Miscellaneous:	
H. Rep. No. 708, 72d Cong., 1st Sess., p. 47	6
Regulations 37 (1919 Ed.), Art. 24	14
Regulations 37 (1921 Ed.), Art. 24	13
Regulations 63 (1922), Art. 20	12
Regulations 68 (1924), Art. 18	12
Regulations 70 (1926 Ed.), Art. 18	12
Regulations 70 (1929 Ed.), Art. 18	11
Regulations 80, Art. 18	11
Restatement, Trusts (1935), Sec. 42 (b)	7
S. Rep. No. 665, 72d Cong., 1st Sess., p. 50	6

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 484

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES H. MARSHALL, ADMINISTRATOR OF THE ESTATE OF JOSEPHINE B. MARSHALL, DECEASED

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 20–24) is not reported. The *per curiam* opinion of the Circuit Court of Appeals (R. 30) is reported in 91 F. (2d) 1010.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 6, 1937 (R. 30). The petition for a writ of certiorari was filed October 6, 1937, and

was granted November 8, 1937. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether Section 302 (c) of the Revenue Act of 1926, as amended by Joint Resolution of March 3, 1931, and Section 803 (a) of the Revenue Act of 1932, may be applied to trusts created before the dates of passage of the amendments.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 9–14.

STATEMENT

The facts as stipulated (R. 8–19) and as found by the Board of Tax Appeals (R. 19–22) are as follows:

Josephine B. Marshall died, intestate, June 4, 1933, a citizen of the United States and a resident of New York. Respondent, her son, is the administrator of her estate (R. 20).

By an instrument executed November 15, 1920, she transferred to her son certain cash, stocks, bonds, and other securities, which had at that time a value of approximately $420,000 (R. 20–21).

On the same day, November 15, 1920, the decedent concurrently entered into a supplemental agreement with her son (R. 14–18, Ex. B), which—after reciting the fact of the first agreement, and

"the understanding" of the parties that in the event of the son's death during his mother's lifetime the securities and cash described in the schedule, or securities and cash of equal value, should be reconveyed to her—provided as follows (R. 14–15):

> I. The party of the second part may retain the securities described in the annexed Schedule, or in his discretion, may sell the same, or any part thereof, from time to time and shall invest and reinvest the proceeds and the cash thereof in other securities as nearly as possible equal in value to the cash and to the present fair market value of the securities described in the annexed Schedule, and shall pay over to the party of the first part such portion of the income from the said securities as she may from time to time request in writing.
>
> II. The party of the second part, during the lifetime of the party of the first part, shall carry all of the securities and cash described in the annexed Schedule and any other securities in which the proceeds of the securities and the cash described in the annexed Schedule shall have been invested or reinvested, in a separate account to be known as "Charles H. Marshall, Special Account," or some name of a similar nature.
>
> III. The party of the second part, by his last will and testament, shall bequeath to the party of the first part, provided she survive him, all of the securities constituting, at the

date of his death, the above mentioned "Charles H. Marshall, Special Account."

IV. The party of the first part shall from time to time reimburse the party of the second part for the increased amount of any State and Federal income taxes which the party of the second part shall be required to pay by virtue of the conveyance to him of the securities and cash described in the annexed Schedule.

V. The party of the first part, in the event that she survive the party of the second part, shall pay to his executors, upon the transfer to her of the securities then constituting the above mentioned "Charles H. Marshall, Special Account," the amount of any State and Federal inheritance taxes due by virtue of such transfer.

VI. This agreement shall be binding upon the heirs, executors, administrators, and assigns of both parties hereto.

During the decedent's life the son, in accordance with paragraph I of the agreement, paid to the decedent or for her account such portions of the income derived from the Special Account as she requested. In accordance with paragraph III he executed a will early in December 1920, bequeathing to his mother the securities in the Special Account as of the date of his death, and directing that all inheritance taxes thereon should be deducted therefrom. This provision of his will was revoked after his mother's death in 1933 (R. 22).

The Commissioner included the value of the securities, $468,115.07, in the decedent's gross

estate as property of which she had made a transfer within the meaning of Section 302 (c) of the Revenue Act of 1926, as amended, and determined a Federal estate tax of $40,858.34 (R. 20). The Board of Tax Appeals reversed the Commissioner's determination (R. 25), and the Circuit Court of Appeals affirmed, *per curiam*, upon the authority of *Welch* v. *Hassett*, 90 F. (2d) 833 (C. C. A. 1st), and *Bullard* v. *Commissioner*, 90 F. (2d) 144 (C. C. A. 7th), both now pending before this Court, Nos. 375 and 349, respectively.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the property embraced within the transfer effected by the two instruments of November 15, 1920, could not be included in the decedent's gross estate in accordance with Section 302 (c) of the Revenue Act of 1926, as amended.

2. In not holding that Section 302 (c) of the Revenue Act of 1926, as amended, was applicable and constitutional as applied to said transfer.

3. In affirming the decision of the Board of Tax Appeals that there is no deficiency in the estate tax, instead of a deficiency of $40,858.34, as set forth in the notice of deficiency.

ARGUMENT

The transfer of November 15, 1920, is embraced within the provisions of Section 302 (c) of the Revenue Act of 1926, as amended by the Joint Resolution of March 3, 1931, and as further amended

by the Revenue Act of 1932 (see Appendix, *infra*, pp. 9–10), which deals specifically with a

> transfer, by trust or otherwise, under which he [the transferor] has retained for his life * * * (1) the possession or enjoyment of, or the right to[1] the income from, the property * * *

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[1] The phrase "the right to" was added by the Revenue Act of 1932, and did not appear in the Joint Resolution of March 3, 1931. However, Congress had understood the Joint Resolution as so providing, and regarded the additional phrase in the 1932 Act merely as a clarification. See H. Rep. No. 708, 72d Cong., 1st Sess., p. 47; S. Rep. No. 665, 72d Cong., 1st Sess., p. 50.

In the court below, respondent relied on those committee reports as declaring that the provisions amending Section 302 (c) were to be "without retroactive effect." But such reliance was based on a misreading of the reports. The 1931 amendment was changed in the 1932 Act in four respects. Two of the changes were merely for purposes of clarification. Thus as to the first (the insertion of the words "or for any period which does not in fact end before his death"), both reports specifically state "This is a clarifying change and does not represent new matter." *Ibid.* Similarly as to the second change (the insertion of the words "the right to the income" in place of "the income"), both reports declare "This is also a clarifying change." *Ibid.* However, the remaining two changes in the 1932 amendment (not involved in this case) made rather radical departures from the 1931 amendment. It is that new material that the committee reports declared to be "without retroactive effect." Thus the report of the House committee states (p. 46):

"The purpose of this amendment to section 302 (c) of the revenue act of 1926 is *to clarify* in certain respects *the amendments* made to that section by the joint resolution of March 3, 1931, which were adopted to render taxable a transfer under which the decedent reserved the income for his life. The joint resolution was designed to avoid the effect of decisions of the Supreme Court holding such a transfer not

The issues herein are substantially identical with those in *Hassett* v. *Welch,* No. 375, present Term, and we respectfully refer the Court to our brief in that case, where we contend not only that Congress meant to reach transfers made before the 1931 and 1932 amendments, but that the tax, as so applied, does not contravene the due process clause.

The only variation here is that the transaction was effectuated through two instruments instead of one, and that the retention of the life interest was in the form of a binding promise of the transferee or trustee. That variation, however, should not be material. Cf. Restatement, Trusts (1935) § 42 (b), and comment *a.* Otherwise, the effectiveness of these provisions would be reduced to nothing, since it would be a trifling matter for a draftsman in preserving a life estate to the grantor to achieve that result in the same way as was done here. It is hardly likely that Congress intended to furnish so ready a vehicle for the avoidance of this tax.

The state courts have often been called upon to determine whether the transferee's undertaking to pay over the income to the transferor for

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taxable if irrevocable and not made in contemplation of death. *Certain new matter* has *also* been added, *which is without retroactive effect.*" [Italics supplied.]

Substantially the same statement appears at p. 49 of the report of the Senate committee. Accordingly, it is clear from those reports that the basic amendment of 1931 and the clarifying provisions of 1932 were not restricted to prospective operation only, but that only "certain new matter," not involved here, was to be "without retroactive effect."

life or to reconvey a life estate was the equivalent of a *reservation* of a life interest, and their answer has uniformly been in the affirmative. *In re Hubbs*, 41 Ariz. 466; *People* v. *Estate of Moir*, 207 Ill. 180; *In re Estate of Schuh*, 66 Mont. 50; *In re Perry*, 111 N. J. Eq. 176; *In re Harvey*, 2 N. J. Misc. 247, affirmed, *sub nom. Moore* v. *Bugbee*, 3 N. J. Misc. 435, *affirmed*, 102 N. J. L. 720, writ of error dismissed, 278 U. S. 565; *American Bd. Comm'rs* v. *Bugbee*, 98 N. J. L. 84; *Matter of Miller*, 236 N. Y. 290, 295–296; *Barber's Estate*, 304 Pa. 235; *Reish. Adm'r* v. *Commonwealth*, 106 Pa. 521; *Conwell's Estate*, 5 Pa. Co. Ct. 368; *Meyers's Estate*, 16 Pa. Dist. Rep. 284; *Estate of Ogden*, 209 Wis. 162. Cf. *In re Wallace's Estate*, 282 Pac. 760 (Ore.). That Congress intended a like result here seems too plain for further comment.

CONCLUSION

The judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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DECEMBER 1937.

APPENDIX

As originally enacted, Section 302 (c) of the Revenue Act of 1926, c. 27, 44 Stat. 9, provided:

> The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—
>
> * * * * *
>
> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * * (U. S. C., Title 26, Sec. 411.)

The Joint Resolution of March 3, 1931, c. 454, 46 Stat. 1516, amended subsection (c) to read as follows (the language in italics representing the new matter):

> (c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, *including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom;* except

in case of a bona fide sale for an adequate and full consideration in money or money's worth. (U. S. C., Title 26, Sec. 411 (c).)

Section 302 (c) was further amended by Section 803 of the Revenue Act of 1932, c. 209, 47 Stat. 169, to read as follows:

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title. (U. S. C., Title 26, Sec. 411,)

Section 302 (h) of the Revenue Act of 1926, *supra:*

Except as otherwise specifically provided therein subdivisions (b), (c), (d), (e), (f), and (g) of this section shall apply to the transfers, trusts, estates, interests, rights,

powers, and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after the enactment of this Act. (U. S. C., Title 26, Sec. 411.)

Regulations 80 (1934):

ART. 18. *Transfers with possession or enjoyment retained.*—(a) *Transfers included.*—The statutory phrase, "a transfer * * * intended to take effect in possession or enjoyment at or after his death," includes a transfer, whether in trust or otherwise, made subject to the reservation by the decedent of the use, or the possession, or the rents or other income of the transferred property, or any part thereof, for his life, or for a period ascertainable only by reference to his death, or for a period of such duration as to evidence his intention to retain the enjoyment (in whole or in part) of the transferred property throughout his life. (See article 15.)

(b) *Taxability.*—Every such transfer (not amounting to a bona fide sale for an adequate and full consideration in money or money's worth), made by the decedent subsequent to September 8, 1916, is taxable, and the value of the property or interest so transferred shall be included in the gross estate of the decedent. The provisions of this subdivision do not apply (1) if the transfer was made prior to 10:30 p. m., eastern standard time, March 3, 1931, and (2) if the decedent died prior to 5 p. m., eastern standard time, June 6, 1932. See section 506 of the Revenue Act of 1934.

Regulations 70 (1929 Edition):

ART. 18. *Reservation of income or an annuity.*—A transfer, not amounting to a bona

fide sale for an adequate and full consideration in money or money's worth, is taxable where the decedent reserved to himself during life the entire income of the property transferred. In such a case the transfer of the principal takes effect in possession and enjoyment at the death of the decedent, and the value of the entire property should be included in the gross estate.

Where the decedent reserved only a portion of the income, only a corresponding proportion of the value of the property should be included in the gross estate, unless, however, the possession or enjoyment of the remaining portion of the transferred property, or a part thereof, was postponed until at or after the decedent's death, in which case there should also be included in the gross estate such remaining portion or part thereof, as the case may be. Thus, for example, if the reservation was one-half of the income then one-half of the value of the transferred property should be included, and if, in addition to such reservation, it was intended by the decedent that possession or enjoyment of the remaining portion of the property should be postponed until at or after his death, then the value of the entire property should be included.

* * * * *

Article 18 of Regulations 70 (1926 Edition), and of Regulations 68 (1924) contains in substantially the same language the foregoing provisions of Article 18 of Regulations 70 (1929 Edition).

Regulations 63 (1922):

ART. 20. *Reservation of income.*—A transfer, not amounting to a bona fide sale for a fair consideration in money or money's worth, is taxable where the decedent re-

served to himself during life the income of the property transferred. In such a case the transfer of the principal takes effect in possession and enjoyment at the death of the decedent, and the value of the entire property should be included in the gross estate. Where the decedent reserved a proportionate part of the income, only a corresponding proportion of the value of the property should be included in the gross estate. If, for example, he reserved one-half of the income, the value of one-half of the property transferred should be included in the gross estate. If he reserved an annuity, so much of the property as is necessary to produce the annuity should be included in the gross estate. A transfer is taxable in accordance with these principles whether the decedent reserved the annuity out of the property conveyed, or payment thereof to him was made by the grantee upon an express or an implied agreement to that effect. * * *

Regulations 37 (1921 Edition):

TRANSFERS INTENDED TO TAKE EFFECT AT OR AFTER DEATH

ART. 24. *Reservation of income.*—A transfer is taxable where the grantor reserves to himself during life the income of the property transferred. In such a case the transfer of the principal takes effect in possession and enjoyment after the death of the grantor, and the value of the entire property should be included in the gross estate. Where the grantor reserves a proportionate part of the income, only a corresponding proportion of the property should be included in the gross estate, unless the transfer was made in con-

templation of death. If, for example, he reserves one-half of the income, the value of one-half of the property transferred should be included in the gross estate. If he reserves an annuity, so much of the property as is necessary to produce the annuity should be included in the gross estate. Where the property does not produce income, its value as of the date of the decedent's death should be ascertained, and so much of this sum as is necessary to produce the annuity should be included in the gross estate. A transfer is taxable in accordance with these principles whether the grantor makes a reservation of the annuity out of the property conveyed, or exacts from the grantee an agreement to pay the annuity. * * *

Regulations 37 (1919 Edition), Article 24, contains provisions identical with the foregoing.

U. S. GOVERNMENT PRINTING OFFICE: 1937